"DIA - DISTRIBUIDORA INTERNACIONAL DE ALIMENTACIÓN, S.A"

FOOD RETAIL

STUDENT: HUGO SEIA

COMPANY REPORT

22 MAY 2018

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Heading in the right direction?

- We begin the coverage of DIA with a **BUY** recommendation. The Price Target for final FY18 is Eur 4.19, which represents an upside of 25% against the current price.
- In July 2017, the company quoted at Euro 6.41 *per* share (best value in the year), but after disappointing results and peers outperforming, DIA became the most-shorted share in the Stoxx Europe 600 Index reaching the current Euro 3.40.
- This trend may continue if the investments in Argentina become affected by the financial instability in the country (which requested financial assistance to the IMF).
- In order to reduce the high dependence from the Iberian Market, being more than 70% of their sales generated in Portugal and Spain, DIA is investing in Paraguay almost Euro 40 million, to open 90 stores until 2022.
- DIA is currently ranked in the investment grade used by Standard & Poor's as BBB- and for Moddy's as Baa3 risk investment. As such, if the company underperforms, the credit agencies may downgrade DIA to a non-investment/speculative grade increasing abruptly the cost of debt. For example, an increase of 2% in the cost of debt will decrease the Equity Value in Euro 510 million (or Euro 0.82 per share).

Company description

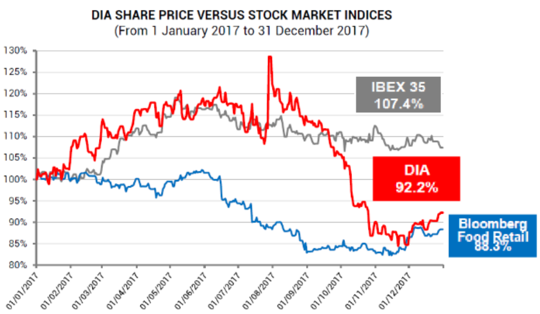
DIA is a Spanish multinational company specialised in the distribution of food, household and personal care ("HPC") products. The company operates in Spain, Portugal, Argentina, Brazil and Paraguay with close to 7,388 stores. In 2017 its sales exceeded Euro 8,8 million.

Recommendation:	**BUY**
Vs Previous Recommendation	---
Price Target FY17:	**4.19 €**
Vs Previous Price Target	---- €
Price (as of 21-MAY-18)	**3.12 €**

Source: Bloomberg.

52-week range (€)	3.04-6.41
Market Cap (€m)	1.942.064
Outstanding Shares (m)	622.456

Source: Bloomberg; Analyst's estimation.



Source: Company's report.

(Values in € thousands)	2017	2018E	2019E	2020E
Revenues	8 776 210	9 249 974	9 741 796	10 233 748
EBITDA	495 872	549 710	569 426	606 165
EBITDA Margin (%)	5.65%	5.94%	5.85%	5.92%
EBIT	247 073	314 027	310 141	316 900
EBIT Margin (%)	2.82%	3.39%	3.18%	3.10%
Net Profit	174 001	109 539	200 522	198 299
NWC/Sales (%)	-9.33%	-9.23%	-9.18%	-9.10%
Capex/Sales (%)	3.45%	3.74%	3.96%	4.17%
Net debt	891 271	682 282	689 869	653 370

Source: Company's report; analyst's estimations.

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Company overview

Distribuidora Internacional de Alimentación, S.A. ("DIA" or "the company") is an international corporation with headquarters in Spain and engages in the food, home and personal care ("HPC") products competitive retail markets and became specialised in managing proximity stores.

DIA was originally founded in 1979 with the opening of its first store in Madrid, introducing the concept of the discount store on the Spanish food and retail sector.

The company relies on three fundamental principles for their business: (i) highly competitive pricing and proximity to customers, (ii) multiple and flexible store formats and (iii) a low-cost distribution model.

These guidelines allowed the company to quickly expand in Spain before deciding to start the internationalisation process, first to Portugal, in 1993, and then Greece, Turkey and France in the years after.

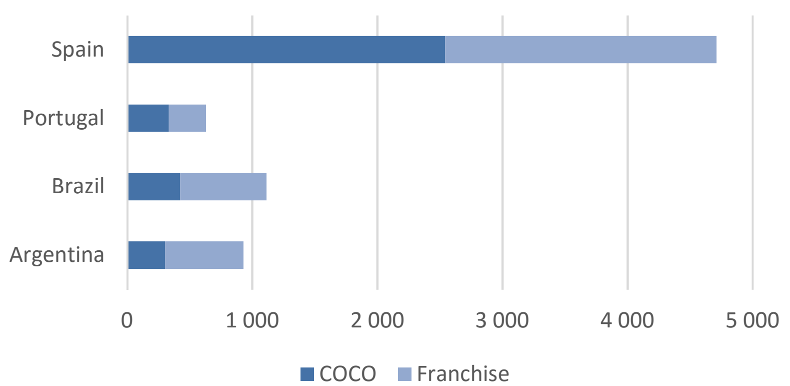
In 2011, the IPO set up the company's equities value at Euro 2,370 million.

In July 2011, the company became listed at Madrid Stock Exchange after a spin-off from Carrefour. In the Initial Public Offering ("IPO"), its shares quoted at Euro 3.50 implying a total equity value of Euro 2,378 million. Before the company's IPO, DIA ceased the French, Greek and Turkish operations.

Currently, DIA has market-leading positions as a food discounter in Spain (#1, 8.6% market share), Portugal (#3, 4.5%), Argentina (#1, 12.4%) and Brazil (#1, 7.0%). In the annual study *Global Powers of Retailing 2018* released by Deloitte, DIA was considered the 98th largest retailer around the world.

In 2017, gross sales under banner reached Euro 8,800 million, relying on an extensive network of more than 7,388 stores (owned stores integrated in the COCO model and franchised stores) in Spain, Portugal, Brazil and Argentina, distributed as follows:

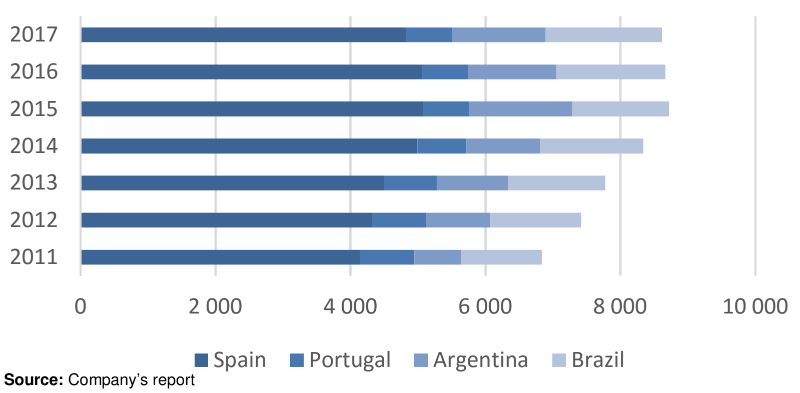
Figure 1: Total stores by country and business model



Source: Company's report

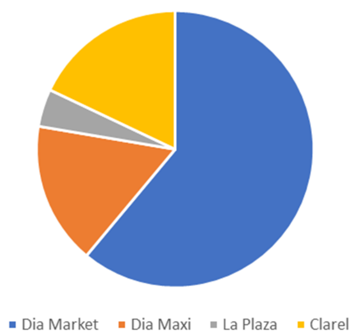
As illustrated below, in 2017 more than 60% of the company's revenues belong to the Iberian market (Spain and Portugal). DIA is focusing to rapidly expand into the Latin American countries - as Brazil, Argentina and more recently Paraguay, where the first stores will open in 2018.

Figure 2: Revenue breakdown



Source: Company's report

Figure 3: DIA stores by banner

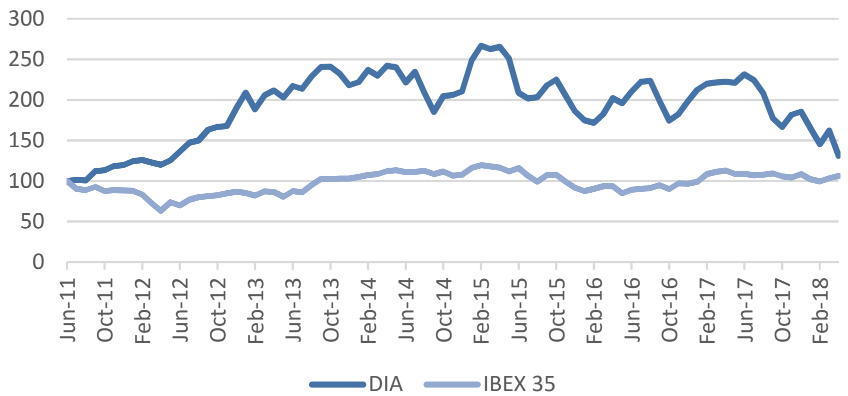


Source: Company's report

DIA operates under different store formats, including *DIA Market*, *DIA Maxi*, *Clarel*, *La Plaza de Dia* or *Minipreço* providing a broad range of products at unbeatable prices to their customer.

As a final remark, from an historical point of view, DIA is above performance of the IBEX 35. For example, in July 2011, if an investor had purchased Euro 100 of DIA's shares, this portfolio would be currently valuated at Euro 131.09 plus Euro 30.69 of dividends in cash.

Figure 4: DIA Performance Vs. IBEX 35



Source: Company's report

In July 2017, the company quoted at Euro 6.41 *per* share (best value in the year) but after disappointing results and outperforming peers, DIA became the most-shorted share in the Stoxx Europe 600 Index reaching the current Euro 3.40.

Strategy

The company aims to follow consumer's trends and offer the best prices on the market, through several private label brands that target different segments of the retail food market and HPC products.

The main focus of the Group is to achieve organic growth through the expansion in several new markets, such as in Latin America.

Furthermore, the Group established several medium and long-term priorities namely (i) continue to improve its business model, (ii) adapt the company to the digital world and (iii) create and implement new business opportunities.

Digital transformation is one of goals set by DIA.

For instance, the company acquired the *Castanola Investments* for the creation of a new website for the Group and started to introduce online shopping in their offer.

The franchise stores shall pursue the objectives set by the company, as they are the main gateway to enter in a new market and represent the Group's image for new clients.

In addition, the company set several drives that define the business model pursued by DIA, as follows:

- **Proximity segment**: DIA is specialised in the proximity store model, providing to the clients an everyday experience.
- **Customer-focused:** The Group follows customer's trends.
- **Best value of money:** The best quality product at the lowest prices. For example, to increase bargaining power, DIA settled multiple agreements with rivals such as, for example, with Casino, in Spain, for its private label products.
- **Quality own brand:** Company's private labels aim to offer the best quality at the lowest prices.
- **Loyalty program:** "Club DIA" allows customers to have immediate access to several discounts in products. Nowadays, more than 80% of the sales of DIA are through the use of this card.
- **Continuous efficiency and improvement:** To offer the most competitive prices, it is necessary to ensure efficiency in all the processes.
- **Franchise store model:** The Company aims to consolidate the position as franchise leader in Spain and the number 3 retailer in Europe.
- **Profitable growth:** The recent expansion to Latin American countries is one of the main concerns of the Group that takes advantage of the increasing demand for food and HPC products.

- **Focus on an omni-channel approach**: The implementation of an online channel, as an approach to increase the sales and proximity to customers.

Business model

The company relies on self-owned stores – 50% of the company's stores - and in the franchise stores – the remaining 50% - to sustain its continuous organic growth.

In this regard, the company uses three different management models, as follows:

- Company Owned Company Operated ("COCO");
- Company Owned Franchised Operated ("COFO") and
- Franchised Owned Franchised Operated ("FOFO").

Using the COCO stores, DIA remains with "a foot on the ground" being aware of the market dynamics and allowing the company to introduce new concepts in the market, prior to presenting such concepts to the franchise stores. In addition, as the complexity of the business increases with the size of the stores, DIA remains managing the largest size stores.

In the franchise business model, the company depends on a private investor for operating the store's day-a-day operations, remaining the store as legally owned by DIA (or not) depending on the initial investment performed by the private individual or company.

Initially, the company started to bet in the franchise business model through stores operated in a FOFO model. In 2009, the company introduced the COFO model, allowing small investors to manage a franchise store model without a relativity high investment.

In the franchise model, the investor must purchase all the products from DIA and the final prices to the consumer are strict to a maximum price settled by the company.

DIA's stores are segmented in three principal categories as: the proximity stores (until 700 sqm), supermarket stores (above 700 sqm) and HPC stores.

Furthermore, the proximity stores represent almost 80% of the total stores managed by the company, followed by the HPC stores using the banner *Clarel*. These reach almost 17% of the total stores and supermarket business represents the 3% remaining stores.

Nowadays, as mentioned above, the conception of self-owned labels for different product segments is a tremendous sector trend and DIA has several private labels regarding a wide range of products.

Shareholder Structure

Figure 5: Shareholder Structure

Investing company	% of Capital
LETTERONE INVESTMENT HOLDINGS SA	18.00%
BAILLIE GIFFORD & CO LIMITED	10.48%
COLUMBIA WANGER ASSET MANAGEMENT INC	3.28%
AMERIPRISE FINANCIAL INC.	3.05%
LSV ASSET MANAGEMENT via its funds	3.00%
DELORES HOLDINGS LTD	2.98%
NORGES BANK INVESTMENT MANAGEMENT (OSLO)	2.97%
VANGUARD GROUP INC via its funds	2.52%
TIGER GLOBAL MANAGEMENT	2.39%
MARSHALL WACE LLP	2.19%

Source: Sabi

Since 2011 that DIA's shares are traded in the Madrid Stock Exchange ("IBEX 35"). DIA has 622.5 million outstanding shares being the company's main shareholder *Letterone Investment Holding S.A.* with 18% of DIA's shares. Furthermore, almost all the remaining capital (80%) is held by private investment funds.

It is worth mentioning that *Letterone Investment Holding S.A.* became a shareholder of the company with purchase of 15% of capital in January 2018. In this deal, the investor paid over Euro 407,504 thousand for 93.4 million company's stocks, which meant a DIA's equity valuation of Euro 2,774.9 million.

Geographic Presence

DIA is physically present in 5 countries, as illustrated below, namely:

- Iberia markets: Spain and Portugal;
- Emerging markets: Brazil, Argentina and Paraguay.

Figure 6: DIA's presence

Source: Company's website

From a pure sales perspective, the company's principal market is Spain with 4,713 stores (of a total of 7,388) accounting with 56% of the total sales (2017). In addition, the ratio of sales by store in Spain stood at Euro 1.024 million, in 2017.

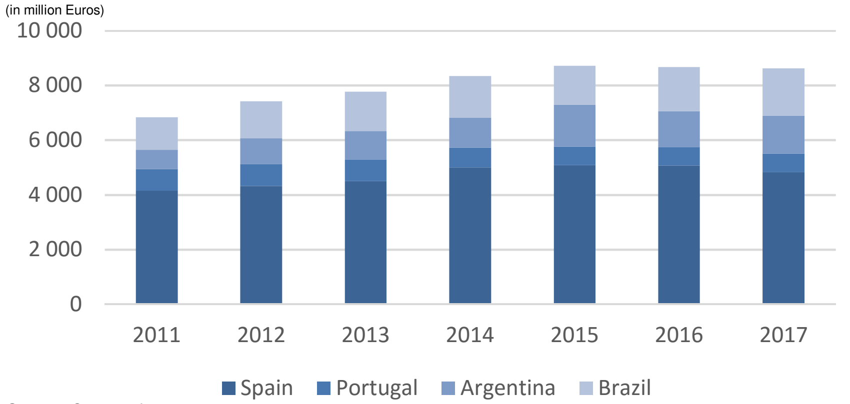
Inside the Iberia markets, Portugal is gradually losing its importance as the sales associated to this market are consistently decreasing. In 2017, it only represented 7.86% of the total revenue distributed in 630 stores.

Iberia markers are the most relevant segment.

Notwithstanding, in 2017, Iberia markets are the most relevant segment, with almost 64% of the total revenue of the company. Portugal and Spain together registered €5,505 million in sales and in a total of 5,343 stores.

Furthermore, in the Emerging market segment, Brazil stands out accounting with 20% of the company's sales in 2017 among the 1,115 stores in the country. For these stores, 691 operate under the franchise business model.

Figure 7: Revenue breakdown



Source: Company's report

As illustrated in the figure 7, the sales in Brazil are constantly increasing since 2011 and improved almost 50% between the historical years under analysis (2011 and 2017).

Moreover, Brazil's macroeconomic context played in the company's favour, as a severe economic recession created the ideal conditions for the company's expansion, based on the proximity and low-price policies. In addition, Brazilian customers were very receptive to the company's loyalty program, that there surpassed the 4 million members barrier.

Argentina is one of the Emerging markets where the company is present. The sales on this country have been severely punished by the hyperinflation registered in the country and the abrupt Argentinian peso devaluation. Nonetheless, the company remains committed with its expansion plan in Argentina as, in 2017, the total stores increased from 872 to 930, due to the franchise model widely used in this country.

Recent investment in Paraguay…

In Paraguay, the company settled a distribution centre by the end of 2016. Until the end of 2017, the company did not have any store in the country, but DIA started an investment of almost Euro 40 million to open in the country 90 stores until 2022. The initial target will be to scale up to 22 stores, with long term expectations of 90 stores within 5 years.

Nevertheless, the Emerging markets represent 35% of the total sales and 25% of the total number of stores. In these countries, the company expects to benefit from rapid growth, supporting the expansion of the company and contrasting with the low levels of expansion on the Iberia markets.

The growth strategy in Emerging markets is set by the use of the franchise business model and, after a quick expansion, followed by the opening of large COCO stores.

Not all investments performed by the Group are being made in the Latin American countries.

… and disinvested in China.

In 2003, DIA entered China and reached about 200 convenience stores in Shanghai. China's market is highly competitive, resulting in the company's revenues declining to Euro 181.5 million in 2017 and its losses increasing by 35% to Euro 21.4 million. In the beginning of 2018, DIA left the China market and sold its local stores to a unit of the Chinese retail giant Suning Group.

Retail industry

The retail industry comprises the companies that produce and sell goods and services.

As a HSBC bank industry report remarks, this is a broad industry comprised by specialised retailers, in areas such as:

- Food retailers;
- Beverages;
- Food and HPC;
- General retailers and
- Luxury items retailers.

The food retail industry

The food retail industry is the largest sub-sector of the retail industry in terms of revenue and it is mainly focused on the sale of consumer goods (groceries) but also non-food products as HPC and similar products.

This sub-sector of the retail industry plays an important role in the global economies and markets, as it links between producers to the final consumers, bringing advantages to both sides. In this role, retailers have the ability to offer the final consumer a wide variety of goods in the same place and to easily absorb a large production batch of a single product from its suppliers.

Furthermore, most players on this industry use standardise stores, each one adjusted to the target customer and a wide of products offered, as follows:

- *Hypermarkets,* are the most complete stores. Usually, these stores have between 2,500 m^2 and 5,000 m2;

- *Supermarkets*, include stores between 400 m^2 and 2499 m^2 and offer only essentially food products and a limited number of non-food products;
- *Discount stores*, non-defined size and sell a very limited quantity of products at low prices;
- *Convenience stores*, are small stores located close to customers with a small variety of food products;
- *Cash and Carry*, are stores that target small retailers usually from the HORECA channel selling products in bulk at low prices;

Sector Trends in Europe

The European food retail sector is constantly being affected by globalization as market competition is more aggressive than ever, customers are always more demanding and producers depend less of the traditional food retail chain to sell their products.

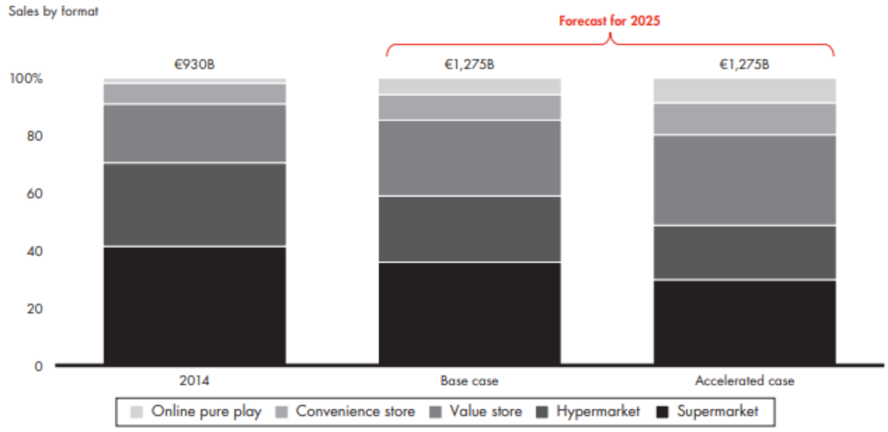
The large Groups playing in this industry are quickly adapting to this dynamic environment and aim to boost their sales.

Retail market is in a very mature stage.

A CBI - Ministry of Foreign Affairs of the Netherlands's study foresees that this sector will remain stable in Europe, as it is not expected an increase higher than 2% *per* year. In this context, the competition is severe and to remain in this market on the long run, the major players of this industry will have to face challenges, as:

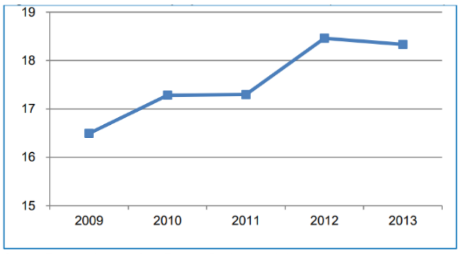
- **Adapting the supply chain to technologies** – Standardisation of the barcodes and RFID technology used into the communication between manufacturers and retailers, increasing the efficiency of the supply chain, reducing costs to producers and retailer and lowering the prices to customers;
- **Changing competitive landscape** – E-commerce will have a bigger influence on the global market competition, as it offers new sales opportunities for a cheaper price for square metres in stores. On the other hand, for the customer, the price will remain the most important criteria on selecting the product. It is also expected an increase of the private labels market share in the EU countries where they have relatively low importance (e.g. Eastern and Southern Europe);

Figure 8: The grocery landscape in Europe should be significantly reshaped by 2025



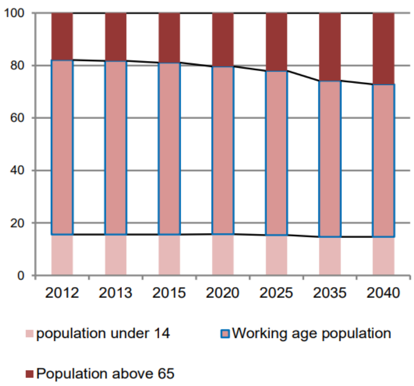
Source: Planet Retail.

Figure 9: Sold volume of prepared meals in the EU (thousands of tons)



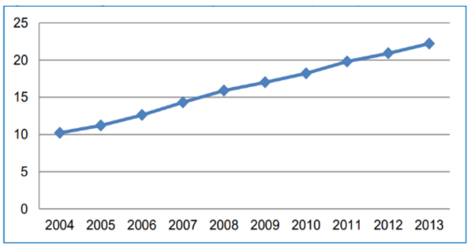
Source: Ecorys calculation from Eurostat Prodcom statistics.

Figure 10: Actual and projected population structure in EU



Source: World Bank

Figure 11: EU organic market development 2004-2013 (billion €)



Source: FiBL-AMI surveys 2006-2012, OrganicDataNetwork.

- **Demographic shifts** - The most influencing trend seems to be urbanisation, as it will have a major impact on this market (in 2014 more than 73% of European citizens already lived in cities). These consumers want to have easy and quick access to food, which means making supermarkets closer to the customer. An aging population demands a smaller proportion, an easy-to-open packaging and readable labels. Growing ethnic and cultural diversity will lead to retail having more variety of products;
- **Growing consumer's concerns about sustainability** – Customers are more aware of the ecologic footprint caused by their consuming habits. Therefore, the whole supply chain will be forced to became more sustainable, especially on the environmental impact of processes and transportation. Organic and *slow food* movements will continue to grow but remain relatively niche markets.
- **Increased awareness of health and wellbeing** – This trend will force producers and retailers to be more aware of the products composition, as consumers demand healthier products, e.g. lesser salt, calories and fat but more fibres.
- **Increase in consumer service demands** – Customers are more demanding concerning the range of product available as personalisation becomes a trend. Moreover, customers are also demanding 24/7 accessibility, with online sales opportunities (e-commerce) increasing.
- **Increase in regulatory pressure** – The fat tax concerns are increasing as many EU states implement this tax. Movements defending animal's wellbeing are increasing as well as environment and sustainability are becoming a big concern.

The major players in this sector are well aware of these challenges and all of them are attempting to grow sales and offer the lowest prices in a very competitive environment.

Furthermore, in attempting to reduce costs and prices to the final consumer, many of the retailers are creating private labels that result from agreements between retailers and manufacturers, where the manufacturer's products are sold using the retailer's brand. This process cuts out intermediates in the supply chain, reducing costs and allowing these products to have a more competitive price than international brand products. Manufactures are allowed to produce taking advantage of the installed capacity, allowing them to reduce production costs even more.

Private labels gained a significant importance.

Therefore, the private label products have rapidly gained market share. In the grocery products, private labels have a significant importance in countries such as Switzerland (45%), United Kingdom (41%) and Spain (41%).

Moreover, many retailers have been creating joint purchase agreements to gain bargaining power and reduce product prices. These agreements are widely used for the acquisition of private label goods, reducing even more the costs of these products.

To increase sales, retailers have been introducing several non-food products, as electronic products and home accessories, enabling customers to have an increasingly broad variety of products.

In addition, European retailers are rapidly expanding to other EU countries or even to the emerging markets, in an attempt to grow sales. One of the main strategies to expand is to acquire local companies, with an already implemented supply chain and benefiting of the existing brand awareness of the acquired company.

However, some retailers choose to create joint ventures with local retailers, establishing a franchise store, as well as betting in the creation of their own subsidiaries in the new countries.

The scale of large European retailers has an immediate consequence in the traditional retail business, as small businesses could not offer the widely variety of products at the lowest price that are available at big retailer's stores. For this reason, one of the trends of the food retail in Europe is the partnership between the traditional retailers and the large European retailers. This partnership benefits both sides, as large retailers profit from the connection between traditional retailers and the customer, as the big retailers increase their brand awareness and remain close to customers.

Online shopping will dramatically change the industry.

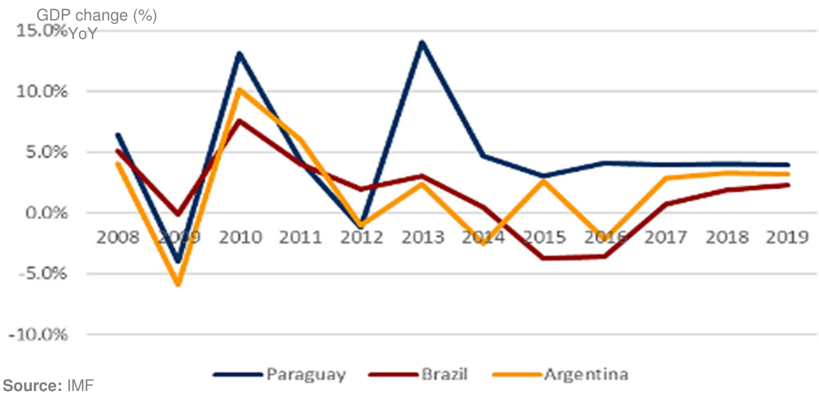
Finally, it is worth mentioning that technological advances will transform the way customers interact with retailers. In the long run, online shopping and stores with self-checkout systems will be the standard of this industry, cutting even more the costs and prices for consumers.

The last trend in the European food retail sector is the introduction of in-store technology and the creation of e-commerce platforms. Both trends have the same premise, make shopping easier and quicker.

Retailing trends in Latin America

The Latin American countries have been dealing with a negative macroeconomic performance in the recent years. In this situation, consumers are forced to increasingly seek for products at the lowest prices possible. The retailers answer this demand investing in private labels to reduce prices to their customers.

Figure 12: Economic performance of Emerging countries



Source: IMF

As their clients are become more open to private labels, retailers are expanding the range of products that they offer as private label, as well as strengthening the positioning of those brands. Private labels allow retailers to quickly respond to trends that emerge from fast-changing consumer purchasing habits.

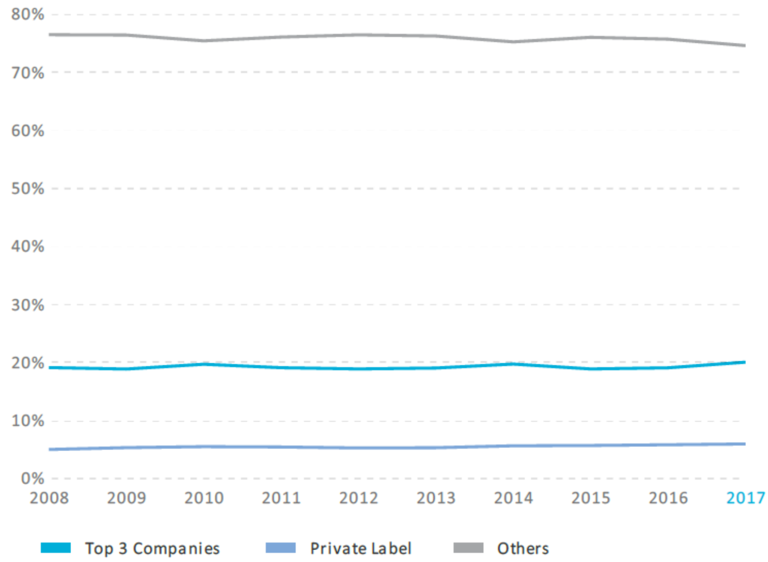
In these countries, alcoholic drinks and products for babies, such as nappies/diapers and baby food, are less likely to be replaced by cheaper brands or products.

Brazil and Argentina are two of the larger economies within the Latin American countries. Since 2012, those economies faced uncertainty as their GDP decrease, inflation rates and unemployment levels rose and exchange rates remained volatile. All these factors are currently affecting their consumer's disposable income and their ability to spend.

To stimulate consumers, the retailers offer the possibility to pay in interest-free instalments. This strategy is widely used in Brazil as the consumers were very receptive to it.

In Latin American countries the big retailers are not dominant yet, as traditional business continues to stand as deep-rooted in these countries culture.

Figure 13: Market Concentration of Packaged Food by Company in Argentina

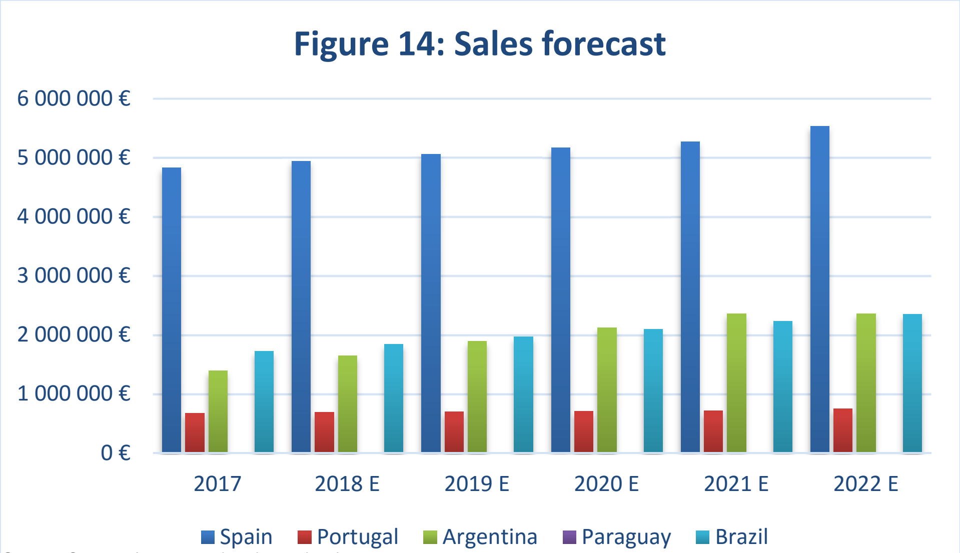


Source: Passport

Promotions, notably, the ones where the consumer buys several items of the same product at a lower price, have been a key tool used by retail players during tough economic cycles.

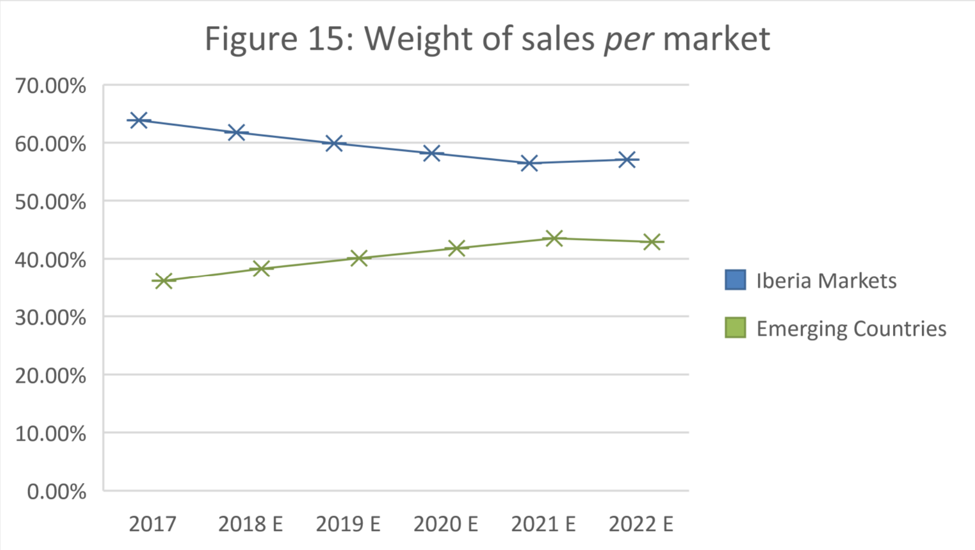
Valuation

For determining the equity's value of DIA, we decided to use the Discount Cash Flow ("DCF") methodology. This way, for the purpose of the valuation model, we forecasted the future cash-flows of the company based on the analysis performed to the retail market industry in Europe (particularly in Portugal and Spain) and in the emerging countries (as in Brazil, Paraguay and Argentina) duly identifying the fundamental drives of such industry. Please note that all the amounts were estimated in Euros.



Source: Company's report and analyst estimation

In addition, for the data collected, as illustrated in figure 15, we estimate that the Iberian markets will continue to loss relative importance in the total sales of the company.



Source: Company's report and analyst estimation

Furthermore, for discounting the Free Cash Flow ("FCF"), we used the Weighted Average Cost of Capital ("WACC") methodology as it is a better approach to the cost-opportunity faced by different investors to perform such investment in DIA.

WACC and *g* assumptions

Figure 16: WACC assumptions	
Risk-free rate	0.62%
Beta-Levered	0.83
Risk Premium	5.08%
D/(D+E) Ratio	0.34
Return on Equity	4.83%
Cost of debt	1.31%
WACC	3.49%

Source: Analyst's estimation; Bloomberg and Damodaran

In order to determine the WACC of DIA, we have taken into consideration a risk-free rate corresponding to the yield of an investment in a German Bund with a 10-year maturity.

As a reference for the risk premium demanded for the equity investors, we assumed the implied risk premium for the S&P 500 for January 2018.

The beta levered applicable to DIA was extrapolated from the beta levered observed in the retail food industry after the necessary adjustments.

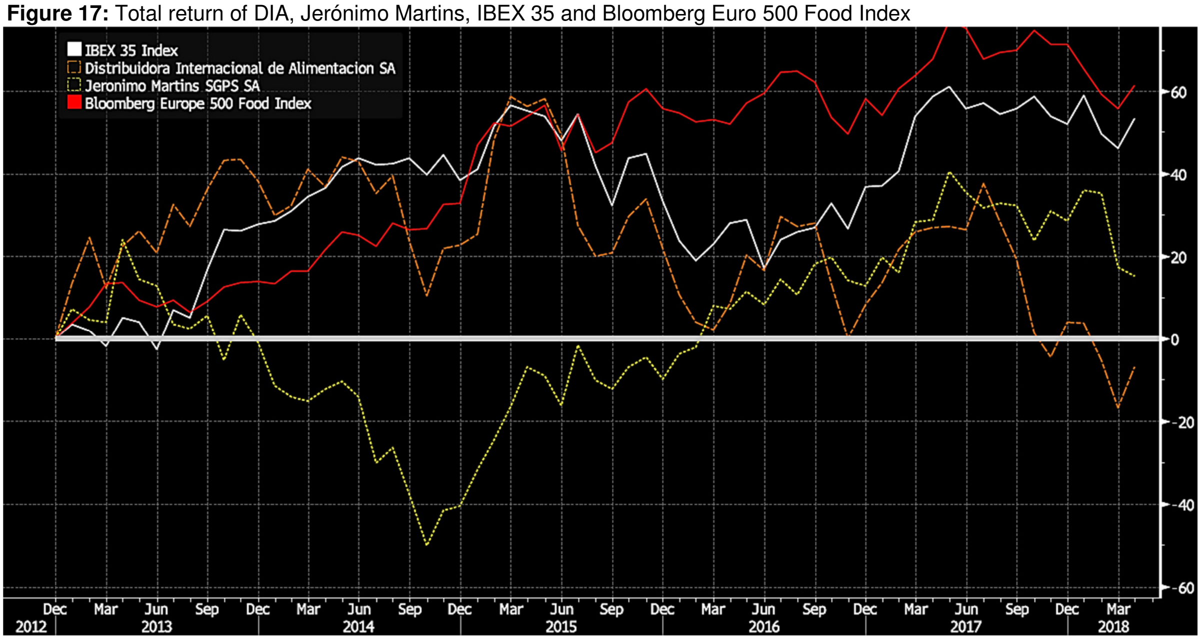
Afterwards, the WACC determined to discount the FCF of DIA was 3.78%, as illustrated in figure 13.

For the perpetual growth (also known as "*g*") applicable to the perpetual FCF of the company, we applied a 1% nominal rate.

Please note that this estimated perpetual growth outcomes from the fact that:

- In Europe, the retail industry is highly competitive and is a very mature market as the historical data of the company denotes a decreased in performance and in the price share, as evidenced in figure 15;

Figure 17: Total return of DIA, Jerónimo Martins, IBEX 35 and Bloomberg Euro 500 Food Index



Source: Bloomberg

- The investments performed by the company in the Americas are risky and could not originate such good results as forecasted;
- The recent investments of the company in Argentina could be at stake after the country required financial assistance to the International Monetary Fund.

Methodology results

As mentioned before, the company was valuated using DCF methodology. With the sum of the discounted Free Cash Flows generated by the Company, it was determined an Enterprise Value of Euro 2,605 million. Therefore, the target price was set at Euro 4.19 per share, as follows:

Figure 18: DCF Valuation

DCF	
Enterprise value	
Present value of Free Cash Flow	335 972
Terminal Value	3 427 578
Discount Factor	0.87
Present Value of Terminal Value	**2 987 832**
% of Enterprise Value	*90%*
Enterprise value	**3 323 805**
Less: Total debt	949 666
Plus: Cash and Cash Equi.	215 693
Plus: Investment in other companies	417
Plus: Other financial assets	14 856
Implied Equity Value	**2 605 104**
Minoraties	0
Shareholders equity	**2 605 104**
Outstanding shares	**622 456 513**
Implied Fair Value	**4.19**

Source: Analyst estimation

Based on the current quotation of DIA, we issued a BUY recommendation as an investment in the company will generate an expected return of 36%.

Figure 19: Total return	
Price (at May, 21 2018)	3.12 €
Dividends FY17 in 2018	0.07 €
Implied Fair Value	4.19 €
Expected return	36%

Source: Analyst estimation

Please note that, for the target price calculated, the changes in the working capital were determined taking into considering the following assumptions:

Figure 20: Working Capital Assumptions

Current assets	
Operation Cash	2% of the year's sales
Trade and other receivebles	5% of the year's sales
Inventory	6% of the year's sales
Loans to customers	Average from the past 4 years
Current Liabilities	
Trade and other payables	22% of the year's sales
Other current financial liabilities (Personnel and supplier of fixed assets)	Average from the past 4 years

Source: Analyst estimation

Scenario analysis

The scenario analysis performed aims to measure the sensibility of the DCF model to changes in the rates of the perpetual growth (*g*) and WACC, used in the discount rate.

Figure 21: Scenario analysis

Perpetual growth \ WACC	2.99%	3.49%	4.28%	4.78%
4.19 €				
-0.50%	2.83 €	2.34 €	1.77 €	1.49 €
0.00%	3.43 €	2.78 €	2.06 €	1.73 €
0.50%	4.26 €	3.36 €	2.43 €	2.01 €
1.00%	5.51 €	4.19 €	2.91 €	2.38 €
1.50%	7.61 €	5.42 €	3.57 €	2.85 €
2.00%	11.81 €	7.48 €	4.51 €	3.50 €
2.50%	24.54 €	11.62 €	5.98 €	4.43 €

Source: Analyst estimation

Please note that because a large value of the company outcomes from the terminal value, the share price is very sensible to any changes regarding the perpetual growth rate integrated into the model. The projected perpetual rate is a conservative value and, for that reason, we anticipated a scenario where the company goes under a slow increase in results. If the company performs better than anticipated that will boost the company's value.

Furthermore, the company faces a financial risk arising from the current atypical period of low interest rates, that can influence the WACC used as discount rate. A sharp change in the interest rates can greatly influence the valuation of the Company. For example, a 2% increase in the cost of debt would make the equity value of DIA decrease approximately by Euro 510 million (or Euro 0.79 *per* share).

Figure 22: Scenario analysis – Cost of debt increases

Total cost of debt (%)	1.31%	2.31%	3.31%	4.31%	5.31%	6.31%
Implicit WACC	3.49%	3.71%	3.93%	4.15%	4.36%	4.58%
Stock Price	4.19 €	3.74 €	3.37 €	3.04 €	2.75 €	2.49 €

Source: Analyst estimation

In addition, DIA is currently ranked in the investment grade used by Standard & Poor's as BBB- and for Moddy's as Baa3 risk investment. As such, if the company underperforms, the credit agencies could downgrade DIA to a non-investment/speculative grade that would translate into a sharp increase in the cost of debt.

Multiples approach

The multiples approach as a relative valuation method often used in the financial industry to value a company or simply to confirm the results obtained through the DCF model valuation.

In order to apply this methodology to the valuation of DIA, we selected comparable peers from the food retail industry.

The selected peers are multinational European food retail companies quoted in the major European indices.

Finally, as expected, DIA trades closer to the median multiples of companies selected. Please note that we excluded the P/E ratio from *Casino Guichard Perrachon* as is an outlier in our sample.

It can be observed that the TEV/Revenue multiple is higher than the peers multiples, which suggest a healthy store turnover, however the TEV/EBITDA of DIA is lower than the average, which points lower operational margins.

Figure 23: Industry multiples

	Equity multiples (FY17)			
	TEV / LTM Total Revenue	TEV / LTM EBITDA	Price / LTM EPS	Dividend yield
DIA	0.53x	7.06x	20.49x	4.88%
Peers				
Carrefour	0.31x	10.88x	---	2.55%
Casino Guichard Perrachon	0.47x	12.25x		6.20%
Jerónimo Martins	0.63x	11.30x	26.41x	3.74%
Metro	0.25x	5.83x	20.11x	3.91%
Tesco	0.35x	6.47x	16.95x	1.46%
Industry average	0.40x	9.34x	21.16x	3.57%

Source: Bloomberg

Appendix

Financial Statements

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

at 31 December
(Expressed in thousands of Euros)

		Forecast				
	2017	2018	2019	2020	2021	2022
ASSETS						
Property, plant and equipment	1 363 963	1 479 900	1 605 691	1 742 175	1 890 260	2 050 932
Goodwill	553 129	533 413	550 606	548 741	546 472	544 808
Other intangible assets	42 709	36 886	37 966	38 766	39 082	38 175
Investments accounted for using the equity method	974	417	417	498	577	477
Trade and other receivables	73 084	91 291	96 171	101 019	105 935	110 069
Other non-current financial assets	75 013	70 444	67 765	67 970	70 298	69 119
Consumer loans from financial activities	-					
Deferred tax assets	253 983	246 907	271 661	271 706	261 064	262 834
Non-current assets	2 362 855	2 459 258	2 630 276	2 770 876	2 913 688	3 076 414
Inventories	569 644	547 749	577 024	606 114	635 610	660 412
Trade and other receivables	221 846	456 457	480 854	505 095	529 675	550 343
Consumer loans from financial activities	1 070	5 050	4 722	4 266	3 777	4 454
Current tax assets	64 717	67 406	68 171	67 845	67 035	67 614
Current income tax assets	369					
Other current financial assets	18 430	16 507	17 597	18 067	17 650	17 455
Other assets	7 387	7 795	7 784	7 776	7 686	7 760
Cash and cash equivalents	340 193	400 692	317 727	312 576	327 888	339 264
Non-current assets held for sale	39 663					
Current assets	1 263 319	1 501 655	1 473 879	1 521 738	1 589 320	1 647 302
TOTAL ASSETS	3 626 174	3 960 913	4 104 155	4 292 614	4 503 007	4 723 717
EQUITY AND LIABILITIES						
Capital	62 246	62 246	62 246	62 246	62 246	62 246
Reserves	304 676	370 423	490 737	609 716	731 696	851 641
Net profit for the period	109 579	200 522	198 299	203 301	199 907	207 279
Other components	-150 418	-150 418	-150 418	-150 418	-150 418	-150 418
Equity attributable to equity holders of the Parent	326 083	482 774	600 863	724 845	843 432	970 748
Non-controlling interests	-100					
Total Equity	325 983	482 774	600 863	724 845	843 432	970 748
Non-current borrowings	961 945	872 442	816 654	787 212	777 003	779 611
Provisions	42 556	56 500	49 100	48 499	49 164	50 816
Other non-current financial liabilities	2 491	2 491	2 491	2 491	2 491	491
Deferred tax liabilities	2 206	2 206	2 206	2 206	2 206	2 206
Non-current liabilities	1 009 198	933 639	870 451	840 409	830 864	833 124
Current borrowings	269 519	210 532	190 943	178 733	172 290	170 055
Trade and other payables	1 710 828	1 998 010	2 104 798	2 210 907	2 318 500	2 408 968
Current tax liabilities	85 692	86 641	87 692	86 380	86 601	86 828
Current income tax liabilities	10 913	107 973	106 776	109 470	107 642	111 612
Other current financial liabilities	148 865	141 344	142 632	141 871	143 678	142 381
Liabilities directly associated with non-current assets held for sale	65 176					
Current liabilities	2 290 993	2 544 500	2 632 842	2 727 360	2 828 712	2 919 845
TOTAL EQUITY AND LIABILITIES	3 626 174	3 960 913	4 104 155	4 292 614	4 503 007	4 723 717

CONSOLIDATED INCOME STATEMENTS
for the years ended 31 December
(Expressed in thousands of Euros)

	Notes	2017	Forecast 2018	2019	2020	2021	2022
INCOME STATEMENT							
Sales		8 620 550.00	9 129 142.79	9 617 070	10 101 894	10 593 500	11 006 859
Other income		155 660.00	120 830.75	124 725.94	131 853.67	133 267.59	127 669.49
TOTAL INCOME		8 776 210.00	9 249 973.54	9 741 796.00	10 233 747.54	10 726 767.26	11 134 528.95
Goods and other consumables used		-6 808 596.00	-7 181 876.91	-7 549 019.88	-7 922 327.57	-8 316 652.30	-8 631 450.65
Personnel expenses		-808 943.00	-850 355.31	-907 928.32	-951 957.21	-993 099.50	-1 031 983.34
Operating expenses		-645 071.00	-654 060.96	-700 499.66	-737 202.49	-772 742.27	-798 042.94
Amortisation and depreciation; Impairment		-248 799.00	-235 683.95	-259 284.45	-289 264.45	-314 687.78	-333 557.70
Losses on disposal of fixed assets		-17 728.00	-13 969.87	-14 922.59	-16 095.73	-17 792.72	-17 463.40
RESULTS FROM OPERATING ACTIVITIES		247 073.00	314 026.53	310 141.10	316 900.08	311 792.68	322 030.92
Finance income		4 830.00	10 549.50	9 075.13	9 027.66	8 370.57	9 255.71
Finance expenses		-65 868.00	-16 080.46	-14 141.48	-13 157.20	-12 613.32	-12 395.87
Profit of companies accounted for using the equity method		288.00					
PROFIT BEFORE TAX FROM CONTINUING OPERATIONS		186 323.00	308 495.58	305 074.75	312 770.53	307 549.94	318 890.76
Income tax		-55 350.00	-107 973.45	-106 776.16	-109 469.69	-107 642.48	-111 611.77
PROFIT AFTER TAX FROM CONTINUING OPERATIONS		130 973.00	200 522.12	198 298.59	203 300.85	199 907.46	207 279.00
Gains net of taxes of discontinued operations		-21 434.00					
NET PROFIT		109 539.00	200 522.12	198 298.59	203 300.85	199 907.46	207 279.00
PROFIT FOR THE PERIOD ATTRIBUTABLE TO EQUITYHOLDERS OF THE PARENT		109 579.00					
PROFIT FROM CONTINUING OPERATIONS							
PROFIT FROM DISCONTINUED OPERATIONS							
Losses from continuing operations attributable to non-controlling interests		-40.00					
Basic and diluted earnings per share, in euros		0.18	0.32	0.32	0.33	0.32	0.33

DIA, S.A.

(Expressed in thousands of Euros)

DCF Valuation

	Actual					Forecast period			
	2014	2015	2016	2017	2018	2019	2020	2021	2022
Sales	8 116 217	9 021 669	8 795 455	8 776 210	9 249 974	9 741 796	10 233 748	10 726 767	11 134 529
% growth		*10.0%*	*-2.6%*	*-0.2%*	*5.1%*	*5.0%*	*4.8%*	*4.6%*	*3.7%*
Goods and other consumables used	-6 350 654	-7 018 881	-6 767 370	-6 808 596	-7 181 877	-7 549 020	-7 922 328	-8 316 652	-8 631 451
Personnel expenses	-704 940	-847 233	-833 643	-808 943	-850 355	-907 928	-951 957	-993 099	-1 031 983
Operating expenses	-535 029	-644 034	-633 513	-645 071	-654 061	-700 500	-737 202	-772 742	-798 043
Losses on disposal of fixed assets	-11 558	-12 340	-10 811	-17 728	-13 970	-14 923	-16 096	-17 793	-17 463
Total costs	-7 602 181	-8 522 488	-8 245 337	-8 280 338	-8 700 263	-9 172 370	-9 627 583	-10 100 287	-10 478 940
% sales	*93.7%*	*94.5%*	*93.7%*	*94.3%*	*94.1%*	94.2%	94.1%	94.2%	94.1%
EBITDA	**514 036**	**499 181**	**550 118**	**495 872**	**549 710**	**569 426**	**606 165**	**626 480**	**655 589**
% margin	*6.3%*	*5.5%*	*6.3%*	*5.7%*	*5.9%*	*5.8%*	*5.9%*	*5.8%*	*5.9%*
Depreciation and Amortisation	-190 129	-195 617	-240 580	-248 799	-235 684	-259 284	-289 264	-314 688	-333 558
% sales	2.3%	2.2%	2.7%	2.8%	2.5%	2.7%	2.8%	2.9%	3.0%
EBIT	**323 907**	**303 564**	**309 538**	**247 073**	**314 027**	**310 141**	**316 900**	**311 793**	**322 031**
Gross cash flow	400 669	392 934	441 780	409 396	439 801	460 876	495 250	517 353	542 878
Capex					345 798	386 156	426 549	463 088	493 323
% sales					*-3.7%*	*-4.0%*	*-4.2%*	*-4.3%*	*-4.4%*
Increase/Decrease in NWC					-35 282	-40 017	-37 785.82	-41 036	-30 736
Change in other operational assets					-68 489	40 131	-1 901	-11 526	-438
Change in other operational liabilities					46 778	-7 547	781	-941	3 849
Free cash-flows to all investors					**244 552**	**67 060**	**109 168**	**105 885**	**84 578**
Change in non-operation assets (excess cash)					51 024	-92 801	-14 991	5 452	3 222
Investments accounted for using the equity method					-557	0	81	78	-99
Other current financial assets (90%)					-1 731	982	423	-375	-175
Operational and non-operational CF					**195 816**	**158 879**	**123 655**	**100 731**	**81 631**

Net Working Capital	Actual					Forecast period			
	2014	2015	2016	2017	2018	2019	2020	2021	2022
Operating Cash	162 324	180 433	175 909	175 524	184 999	194 836	204 675	214 535	222 691
Trade and other receivables	244 592	272 484	330 207	294 930	547 749	577 024	606 114	635 610	660 412
Inventory	553 119	562 489	669 592	569 644	547 749	577 024	606 114	635 610	660 412
Loans to customers	6 362	6 548	6 220	1 070	5 050	4 722	4 266	3 777	4 454
Total Current Assets	**966 397**	**1 021 954**	**1 181 928**	**1 041 168**	**1 285 547**	**1 353 606**	**1 421 168**	**1 489 532**	**1 547 967**
% sales	11.9%	11.3%	13.4%	11.9%	13.9%	13.9%	13.9%	13.9%	13.9%
Trade and other payables	1 693 113	1 518 843	1 952 848	1 710 828	1 998 010	2 104 798	2 210 907	2 318 500	2 408 968
Other current financial liabilities (Personnel and supplier of fixed assets)	136 189	145 679	134 642	148 865	141 344	142 632	141 871	143 678	142 381
Total Current Liabilities	**-1 829 302**	**-1 664 522**	**-2 087 490**	**-1 859 693**	**-2 139 354**	**-2 247 431**	**-2 352 778**	**-2 462 178**	**-2 551 350**
% sales	22.5%	18.5%	23.7%	21.2%	23.1%	23.1%	23.0%	23.0%	22.9%
Net Working Capital	**-862 905**	**-642 568**	**-905 562**	**-818 525**	**-853 807**	**-893 824**	**-931 610**	**-972 646**	**-1 003 382**
% sales	*-11%*	*-7%*	*-10%*	*-9%*	*-9%*	*-9%*	*-9%*	*-9%*	*-9%*

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Buy	Expected total return (including expected capital gains and expected dividend yield) of more than 10% over a 12-month period.
Hold	Expected total return (including expected capital gains and expected dividend yield) between 0% and 10% over a 12-month period.
Sell	Expected negative total return (including expected capital gains and expected dividend yield) over a 12-month period.

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